

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF HAYFIELD UTILITIES,)
INC. FOR A RATE ADJUSTMENT PURSUANT) CASE NO. 97-457
TO THE ALTERNATIVE RATE FILING)
PROCEDURE FOR SMALL UTILITIES)

O R D E R

On December 10, 1997, Hayfield Utilities, Inc. ("Hayfield") filed its application for Commission approval of proposed sewer rates. Commission Staff, having performed a limited financial review of Hayfield's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 10 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 10 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 24th day of June, 1998.

ATTEST:


Executive Director

PUBLIC SERVICE COMMISSION


For the Commission

COMMONWEALTH OF KENTUCKY
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THE APPLICATION OF HAYFIELD UTILITIES,)	
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STAFF REPORT

Prepared by: Jack Scott Lawless, CPA
Auditor, Financial Audits Branch
Division of Financial Analysis

Prepared by: Renee Curry
Public Utility Rate Analyst
Communications, Water and Sewer
Rate Design Branch
Division of Financial Analysis

STAFF REPORT
ON
HAYFIELD UTILITIES, INC.
CASE NO. 97-457

On December 10, 1997 Hayfield Utilities, Inc. ("Hayfield") filed its application seeking to increase its rates pursuant to 807 KAR 5:076. In order to evaluate the requested increase, Commission Staff ("Staff") performed a limited financial review of Hayfield's test period operations, the year ending December 31, 1996.

The scope of Staff's review was limited to obtaining information as to whether the test period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

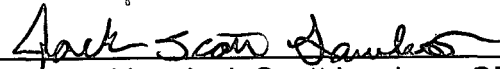
Scott Lawless of the Commission's Financial Audit Branch began the limited review on April 22, 1998. Mr. Lawless is responsible for the preparation of this Staff Report except for the determination of normalized operating revenue and Attachment D, which were prepared by Renee Curry of the Commission's Communication, Water, and Sewer Rate Design Branch.

A comparison of Hayfield's actual and pro forma operations is shown in Attachment A. Based on Staff's recommendations, Hayfield's operating statement would appear as set forth in Attachment B.

Attachment C compares Hayfield's and Staff's revenue requirement calculations. Hayfield determined its pro forma revenue requirement to be \$93,956.23, an increase in revenues of \$51,481.23. Staff recommends a revenue requirement of \$57,112.50 or a

\$13,838.50 increase. The rates contained in Attachment D will achieve Staff's recommended level of revenue.

Signatures

A handwritten signature in cursive script, reading "Jack Scott Lawless", written over a horizontal line.

Prepared by: Jack Scott Lawless, CPA
Auditor, Financial Audits Branch
Division of Financial Analysis

A handwritten signature in cursive script, reading "Renee Curry", written over a horizontal line.

Prepared by: Renee Curry
Public Utility Rate Analyst
Communications, Water and Sewer
Rate Design Branch
Division of Financial Analysis

ATTACHMENT A
STAFF REPORT CASE NO. 97-457
HAYFIELD'S REQUESTED OPERATIONS

	Test Year	Adjustments	Pro Forma Operations
Operating Revenues	\$42,475.00		\$42,475.00
Operation and Maintenance Expenses			
Management Fee	4,800.00		4,800.00
Sludge Hauling	4,486.00		4,486.00
Utility Service - Water Cost	102.00		102.00
Other - Labor	3,665.00	5,695.00	9,360.00
Fuel and Power	11,168.00		11,168.00
Chemicals	1,559.00		1,559.00
Routine Maintenance Fee	7,500.00	1,200.00	8,700.00
Maintenance of Collection System	35,861.00	(15,861.00)	20,000.00
Maintenance of Treatment Plant	4,095.00		4,095.00
Maintenance of Other Facilities	1,703.00		1,703.00
Agency Collection Fee	1,125.00		1,125.00
Office Supplies	96.00		96.00
Outside Services Employed	7,842.00		7,842.00
Insurance Expense	894.00		894.00
Regulatory Commission Expense	500.00		500.00
Transportation Expenses	829.00		829.00
Miscellaneous Expenses	642.00		642.00
Rents	600.00		600.00
Total Operation and Maintenance	87,467.00	(8,966.00)	78,501.00
Depreciation	416.00		416.00
Amortization		500.00	500.00
Taxes Other Than Income Taxes	716.00		716.00
Total Operating Expenses	88,599.00	(8,466.00)	80,133.00
Net Operating Income	(46,124.00)	8,466.00	(37,658.00)
Less: Interest Expense	(1,232.00)	(1,664.00)	(2,896.00)
Net Income	(\$47,356.00)	\$6,802.00	(\$40,554.00)

ATTACHMENT B
STAFF REPORT CASE NO. 97-457
STAFF'S RECOMMENDED OPERATIONS

	Test Year	Adjustments	Ref	Pro Forma Operations
Operating Revenues	\$42,475.00	\$799.00	a	\$43,274.00
Operation and Maintenance Expenses				
Management Fee	4,800.00	(1,200.00)	b	3,600.00
Sludge Hauling	4,486.00			4,486.00
Utility Service - Water Cost	102.00			102.00
Other - Labor	3,665.00	4,655.00	c	8,320.00
Fuel and Power	11,168.00			11,168.00
Chemicals	1,559.00			1,559.00
Routine Maintenance Fee	7,500.00		d	7,500.00
Maintenance of Collection System	35,861.00	(35,861.00)	e	0.00
Maintenance of Treatment Plant	4,095.00			4,095.00
Maintenance of Other Facilities	1,703.00			1,703.00
Agency Collection Fee	1,125.00			1,125.00
Office Supplies	96.00			96.00
Outside Services Employed	7,842.00	(1,167.00)	f	
		(200.00)	g	
		(3,497.00)	h	2,978.00
Insurance Expense	894.00	(158.00)	i	736.00
Regulatory Commission Expense	500.00	(500.00)	j	0.00
Transportation Expenses	829.00	(829.00)	k	0.00
Miscellaneous Expenses	642.00			642.00
Rents	600.00			600.00
Total Operation and Maintenance	87,467.00	(38,757.00)		48,710.00
Depreciation	416.00			416.00
Amortization		417.00	l	417.00
Taxes Other Than Income Taxes	716.00			716.00
Total Operating Expenses	88,599.00	(38,340.00)		50,259.00
Net Operating Income	(46,124.00)	39,139.00		(6,985.00)
Less: Interest Expense	(1,232.00)	1,232.00	m	0.00
Net Income	(\$47,356.00)	\$40,371.00		(\$6,985.00)

ATTACHMENT B
STAFF REPORT CASE NO. 97-457
STAFF'S RECOMMENDED OPERATIONS

(a) Operating Revenues. Hayfield's 1996 annual report indicated that Hayfield had 144 customers with annual revenues from rates of \$42,475.00. Hayfield's 1997 annual report showed Hayfield had 146 customers. With 146 customers, Hayfield's annual revenue from rates should be \$43,274.00 (146 customers x \$24.70 per month x 12 months). For the purposes of this report, Hayfield's 1996 normalized operating revenue will be \$43,274.00

(b) Owner/Manager Fee. Hayfield reported \$4,800.00 for owner/manager fees during 1996. The Commission limits this fee to \$3,600.00 for small investor owned utilities such as Hayfield. Therefore, Staff decreased test year operations by \$1,200.00.

(c) Other - Labor. During the test year Hayfield expensed payments to Beckmar Lab that totaled \$3,665.00. \$585.00 was for a sludge analysis while the remainder of \$3,080.00 was for monthly testing fees. Hayfield proposed to increase the test year expense by \$5,695.00 to recover the cost of weekly testing that is now required by its Kentucky Pollutant Discharge Elimination System ("KPDES") permit. Hayfield calculated its adjustment based on a weekly testing fee of \$180.00.

Staff determined that weekly testing was required after review of Hayfield's KPDES permit. A review of current Beckmar Lab invoices revealed that the cost of a weekly test is \$160.00. Staff calculated the weekly testing adjustment to be \$5,240.00 $((\$160.00 \times 52) - \$3,080.00)$.

Staff eliminated the \$585.00 sludge analysis fee from this account and included a provision for its recovery over a five year period in the amortization expense account. The net adjustment to the other - labor account is \$4,655.00.

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STAFF'S RECOMMENDED OPERATIONS

(d) Routine Maintenance Fee. Hayfield proposed to increase test year expense of \$7,500.00 by \$1,200.00 to recover an increase in the maintenance fee. Four sewer utilities owned by Carroll Cogan filed applications for rate increases on the same date. Three of these companies, including Hayfield, have routine maintenance performed by Andriot-Davidson Company ("A-D"). Martin Cogan, Carroll Cogan's son, and Larry Smither own A-D. During the test year, two companies had monthly fees of \$625.00 and one was \$650.00. The monthly fees proposed in the applications are \$725.00, \$863.00, and \$1,015.00. Despite repeated requests for documentation justifying the wide variance in proposed fees, no information to explain how fees were established was provided. The Commission's Division of Engineering advised that a monthly maintenance fee of \$625.00 appears reasonable. Due to the lack of information justifying the reasonableness of the proposed fees, Staff recommends that the monthly maintenance fees be limited to \$625.00.

(e) Maintenance of Collection System. During the test year Hayfield expensed \$35,861.00 paid to Culver Construction Company for a sewer main replacement project. The total cost of the project was \$60,000.00. Hayfield proposed to reduce the test year amount by \$15,861.00 to reflect a three year amortization of the project's total cost.

Staff obtained a letter dated November 3, 1997, from Carroll Cogan to the Division of Water, which indicated the sewer main replacement project was required for Hayfield to qualify for future connection to Covered Bridge's treatment plant. Through conversations with Carroll and Martin Cogan, Staff discovered that, upon completion of this connection, Covered Bridge will treat all of Hayfield's waste water as Hayfield's

ATTACHMENT B
STAFF REPORT CASE NO. 97-457
STAFF'S RECOMMENDED OPERATIONS

treatment plant will be taken out of service. Martin Cogan indicated that this would happen sometime during the next 12 month period.

Upon completion of the connection, Hayfield will no longer operate as a sewage treatment enterprise. It will function only as a collection system. The rates recommended herein have been based on expenses incurred for the treatment of waste water. Therefore, Staff has eliminated the amounts paid to Culver Construction Company and all other items included in test year expenses associated with this connection.

It is Staff's opinion that Hayfield will no longer be under the Commission's jurisdiction once the connection is complete and Hayfield no longer treats waste water. At that time Hayfield would be entitled to recover these charges through monthly collection fees.

(f) Outside Services Employed – Bookkeeping. During the test year Hayfield reported outside services employed for bookkeeping of \$2,770.00. That amount consisted of \$970.00 paid to Linda Wood and \$1,800.00 accrued payable to Carroll Cogan, owner of Hayfield.

During the review Staff determined that Ms. Wood provides bookkeeping services for all six of Mr. Cogan's sewer utilities for \$185.00 per week or \$9,620.00 annually. Staff has allocated 1/6 or \$1,603.00 of Ms. Wood's annual fee to Hayfield for determining revenue requirements in this case.

Staff has eliminated the \$1,800.00 accrued payable to Mr. Cogan. Staff determined that the only functions Mr. Cogan performed relative to bookkeeping duties for Hayfield was to sign some checks and approve payment of invoices for items that

ATTACHMENT B
STAFF REPORT CASE NO. 97-457
STAFF'S RECOMMENDED OPERATIONS

were either over a predetermined amount or considered out of the ordinary course of business. Staff is of the opinion that the owner/manager fee of \$3,600.00 provides for reasonable compensation for the performance of these duties.

The net decrease recommended by Staff for bookkeeping is \$1,167.00 (\$1,603.00 - \$2,770.00).

(g) Outside Services Employed - Accounting. Logsdon and Co. provides accounting services to Hayfield that includes the preparation of the Commission's annual report and state and federal tax returns. The fee for 1998 is \$1,200.00. Staff has decreased the reported test year expense of \$1,400.00 by \$200.00.

(h) Outside Services Employed - Other Consulting Fees. Hayfield paid Larry Smither \$1,080.00 during the test year to perform weekly inspections and prepare a report summarizing those inspections. Mr. Smither is 50 percent owner of A-D that currently contracts with Hayfield to perform inspections. Staff eliminated the inspection fees of \$1,080.00 as Mr. Smither is already responsible and compensated for inspecting Hayfield's treatment facility as an owner of A-D.

Hayfield paid Mr. Smither \$1,517.00 for consulting work performed with Culver Construction Company on the sewer main replacement project. Staff has eliminated this and all other expenditures associated with this project. For a detailed explanation refer to item (e) of this attachment.

The test year also included \$900.00 for a monthly fee of \$75.00 payable to Martin and Assoc. for serving as a liaison between the utility and the Division of Water ("DOW") and for submission of the monthly discharge monitoring reports. Martin Cogan, son of Carroll Cogan, owns Martin and Assoc. It was reported to Staff that Martin and Assoc.

ATTACHMENT B
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STAFF'S RECOMMENDED OPERATIONS

does not provide this service to any sewer companies not owned by Carroll Cogan. Dealing with DOW and signing the discharge monitoring reports are part of the management function and are compensated by the management fee. Staff does not consider this a prudent, necessary expense and removed it from test year operations.

(i) Insurance Expense. Test year expenses included \$894.00 for insurance expense. According to invoices and policies provided by the utility, the cost of a commercial package for all companies owned by Mr. Cogan was \$5,885.00. The policy covered 8 entities. Staff allocated the cost of the insurance equally to all entities. This results in an insurance expense of \$736.00 and a decrease to test year operations of \$158.00.

(j) Regulatory Commission Expense. Hayfield reported regulatory commission expense of \$500.00. This amount represented partial payment of a DOW settlement for case no. 18475 94 CI 01468. Staff has eliminated this amount as no penalty or fine should be recovered by a utility through rates.

(k) Transportation. Hayfield accrued \$828.75 payable to Mr. Cogan in the transportation expense account. This amount represented a portion of Mr. Cogan's personal automobile lease. No evidence was presented as to the reasonableness of this accrual or its calculation. Staff could not determine what amount should be allowed for Mr. Cogan's transportation expense as a mileage log was not maintained. Staff eliminated \$828.75 from test year operations.

(l) Amortization. Hayfield proposed to amortize rate case expense of \$1,500.00 over 3 years. Staff is of the opinion that rate case expenses should be amortized over the reasonably anticipated life of the rates which generally will not exceed five years. In light

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of the fact that Hayfield's current rates were approved over eighteen years ago, Staff recommends that rate case expenses in this case be amortized over five years.

Staff has amortized the previously mentioned sludge analysis fee of \$585.00 over a five year period. This fee is not an annual expense and its frequency of recurrence is unknown. Therefore, Staff amortized it over the life of the rates to be established in this case.

The net increase for the amortization adjustments is \$417.00 $((\$1,500.00 + \$585.00)/5)$.

(m) Interest Expense. Hayfield proposed to increase test year interest expense of \$1,232.00 by \$1,664.00. The pro forma interest was calculated on a \$60,000.00 loan used to fund the Culver Construction Company project. Staff has eliminated this and all other expenditures associated with this project. For a detailed explanation refer to item (e) of this attachment B.

ATTACHMENT C
STAFF REPORT CASE NO. 97-457
COMPARISON OF REQUESTED AND RECOMMENDED
REVENUE REQUIREMENTS

	Requested by Hayfield	Recommended by Staff
Operating Expenses	\$80,133.00	\$50,259.00
Divide by: Operating Ratio	0.88	0.88
Required Revenue from Operating Ratio	91,060.23	57,112.50
Plus: Interest Expense	2,896.00	0.00
Required Revenue	93,956.23	57,112.50
Less: Normalized Revenue	(42,475.00)	(43,274.00)
Required Increase	\$51,481.23	\$13,838.50

ATTACHMENT D
STAFF REPORT 97-457
RECOMMENDED SEWER RATES

RECOMMENDED RATES

Single Family Residential

\$32.60 per Month